SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

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No. 198

ROBERT R. COX,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 199

ETHEL K. CHILDERS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

Robert R. Stone,
Ellis D. Bever,
Counsel for Petitioners.

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No. 198

ROBERT R. COX,

Petitioner,

vs.

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No. 199

ETHEL K. CHILDERS,

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vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION OF ROBERT R. COX AND ETHEL K. CHILDERS FOR WRITS OF CERTIOARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioners, Robert R. Cox and Ethel K. Childers submit this petition for Writs of Certiorari, to review the decision and judgments of the United States Circuit Court of Ap-

peals for the Tenth Circuit, in the above entitled causes, and file herewith a certified copy of the transcript of the record in said causes and petitioners' brief in support of this petition.

The decision and judgments of the United States Circuit Court of Appeals for the Tenth Circuit (R. 66 and R. 67), reported at 110 F. (2d) 934 (April 4, 1940), affirmed decisions of the United States Board of Tax Appeals (R. 22 and R. 53), reported at 39 B. T. A. 904 (R. 46), and determined that the entire income of a trust created by each of the petitioners was taxable to each of them as grantor under sections 22 (a) (48 Stat. 680, 686) and 166 of the Revenue Act of 1934 (48 Stat. 680, 729). The same question is involved in both cases because the essential features of the trust agreements are identical.

The two cases were consolidated for argument and decision in the court below, although separate judgments were entered. The Board of Tax Appeals filed its findings of fact and opinion in the *Childers* case (R. 46). Only a memorandum opinion was filed in the *Cox* case (R. 22), which was decided upon the authority of the Childers decision. In this petition and brief we shall discuss both cases with reference to the facts of the *Childers* case, since the essential features of the two trust instruments are identical.

Summary Statement of the Matter Involved.

Each of the petitioners transferred property in trust by agreement dated May 16, 1932 (R. 13 and R. 36). Each trust instrument was subsequently amended on June 11, 1932 (R. 21 and R. 46). The Childers trust was amended again on January 8, 1933 (R. 44).

The respondent, in paragraph five, of his answer (R. 33), filed with the Board of Tax Appeals, admits the facts alleged, in paragraphs 5 (a) (R. 31) and in the fifth un-

lettered subparagraph following paragraph 5 (a), of the petition (R. 32), that the title to the securities constituting the corpus of the trust was transferred by the petitioner to the trustees and that, "The petitioner, by virtue of the trust agreement, permanently and definitely divested herself of all title and interest in and to the corpus and to nine-tenths of the income of the trust," subject only to the power of revocation in paragraph Sixth of the trust instrument as amended (R. 46).

The Childers trust agreement names E. K. Childers and Robert R. Cox as trustees and, as amended, provides:

In paragraph Second (b) that one-tenth of all net income should be paid to the donor, E. K. Childers, for and during her life time, and that the remainder of the net income not paid to E. K. Childers should be paid one-fifth each to a son, a daughter, a sister-in-law, and two sisters (R. 38 and R. 45). The son and daughter are minors (R. 35).

In paragraph Second (c) that the income of any beneficiary might be accumulated "for future distribution to such beneficiary" and that each income fund shall be kept separately in the accounts of the trustee as though each income fund constituted a separate trust (R. 39).

In paragraph Second (d) that in case the net income allotted for the benefit of any beneficiary is at any time insufficient, in the opinion of the trustees, for the comfort, maintenance and/or education of such beneficiary, the trustees may pay out such sums from the principal as in their sole discretion may be necessary for such purpose or purposes (R. 39).

In paragraph Third that the trust shall terminate upon the death of the donor, and that the entire corpus and accumulated income shall be distributed to the beneficiaries

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other than the donor, except that the trust should continue as to distributive shares of minors until they reach the age of 25 years. Upon termination of the trust, a complete disposition of all trust property is made and no part of such property could ever revert to the estate of the donor (R. 40).

In paragraph Fourth (c) the trustees are given the usual trust powers of investment including the power to invest in the unsecured notes or bonds of any corporation, firm or syndicate in which the "Trustee E. K. Childers" is at the time a stockholder, partner, or member, if approved by the Donor, and the Trustees shall not be liable for any loss so resulting from any investment so made (R. 42).

In paragraph Fourth (e) the trustees are given the customary power to determine the mode in which expenses are to be borne as between capital and income and to determine the proper division of receipts between capital and income (R. 42).

In paragraph Fifth that in all matters wherein discretion is granted to the trustees, the decision of the "Trustee E. K. Childers" shall be binding (R. 43).

In paragraph Sixth, the Donor reserved the power to alter, amend, or revoke the trust in conjunction with any other beneficiary then *sui juris* and having a substantial adverse interest in the disposition of the corpus of the trust, or the income therefrom (R. 46).

The stipulation of facts (R. 34) was adopted by the Board of Tax Appeals as its findings of fact.

The Commissioner of Internal Revenue determined that the whole income of each of the trusts for the year 1934 was taxable under section 166 of the Revenue Act of 1934, to the respective grantors, petitioners herein, and issued deficiency notices against each of the petitioners (R. 6). Within the time prescribed by law, petitions were filed

with the Board of Tax Appeals and the proceedings were submitted to the Board on stipulations of facts (R. 11 and R. 34). When such stipulations were entered into, counsel for the Commissioner stated that the respondent relied exclusively on section 166 of the Revenue Act of 1934. For that reason any evidence which might be necessary under any other sections was omitted from the stipulation. After the cases were submitted to the Board of Tax Appeals and the petitioners had filed their briefs, the respondent in his brief stated: "The action of the Commissioner was predicated on the application of section 166 of the Revenue Act of 1934. The respondent now also invokes sections 167 and 22 (a) of the Revenue Act of 1934." The Board in its opinion bases its decision upon section 167, declining to decide whether the case came under the provisions of sections 166 or 22 (a) (R. 50). In its opinion in the *Childers* case (R. 46), promulgated on May 18, 1939, the Board held that the petitioner was taxable on the entire income of the trust for the year 1934, stating in its opinion as follows (R. 51):

> "* * * The present case, in our opinion, is clearly within Section 167.
>
> "* * * whether all or any part of the income should be accumulated, whether it was to be treated as corpus, whether the corpus should be invaded and, if so, to what extent, and whether such accumulation or invasion should be for her benefit rested entirely within her discretion. * * *"

A similar conclusion was reached by the Board in the *Cox* case in memorandum opinion entered May 19, 1939 (R. 22).

Each of the petitioners then filed a petition in the Circuit Court of Appeals for the Tenth Circuit, under Section 1141 of the Internal Revenue Code (53 Stat. 164), seeking

a review and reversal of the decisions of the Board. In his brief before the Circuit Court of Appeals the respondent did not contend that the income of the trusts was taxable to the grantor under sections 167 or 22 (a) of the Revenue Act of 1934, but contended that the income was taxable to the grantor under section 166 of the Revenue Act of 1934. The Circuit Court of Appeals for the Tenth Circuit held, in its decision rendered on April 4, 1940, that the income of each of the trusts was taxable to the grantor under sections 166 and 22 (a) of the Revenue Act of 1934.

Statement of the Basis of Jurisdiction of This Court, to Review the Judgment of the Circuit Court of Appeals.

A. This Court has jurisdiction to review the decisions of the Circuit Court of Appeals by virtue of Section 1141 I. R. C., 53 Stat. 164; and 28 U. S. C. 347, 43 Stat. 938.

B. The judgments of the Circuit Court of Appeals sought to be reviewed were entered on April 4, 1940, and the date of filing this petition for Writs of Certiorari with the Clerk of this Court is within three months from the said April 4, 1940.

Questions Presented.

(A) Where the grantor of a trust is one of the trustees and also one of the beneficiaries, does a provision in the trust instrument permitting the trustees, in case the net income allotted for the benefit of any beneficiary is insufficient in the opinion of the trustees for his comfort, maintenance and/or education, to pay to such beneficiary such sums from the principal of the trust as may be necessary for such purposes, constitute a power to revest in the grantor title to the corpus of the trust, within the meaning of Section 166 of the Revenue Act of 1934?

(B) Where property is transferred by an individual to himself and another as trustees, do the powers granted the trustees to withhold and accumulate the income for future distribution to the beneficiaries; to determine the mode in which expenses are to be borne as between capital and income and to determine the proper division of receipts between capital and income; to freely invest the corpus and accumulated income; and to pay to the beneficiaries such sums from the principal of the trust as may be necessary for the comfort, maintenance and education of any beneficiary in the event the income allotted for the benefit of such beneficiary is insufficient therefor in the opinion of the trustees, constitute a power to revest in the grantor title to the entire corpus under section 166 of the Revenue Act of 1934, when the only power reserved in the trust instrument to alter, amend or revoke the trust must be exercised with the consent of a beneficiary then *sui juris* and having a substantial adverse interest to the grantor?

(C) Do the powers granted to E. K. Childers as one of the trustees, together with her relationhsip to the beneficiaries, make the trust a mere "sham" so that it should be disregarded for income tax purposes as lacking substance and the income taxed to the grantor under the provisions of Section 22 (a) of the Revenue Act of 1934?

(D) Could the court below properly consider Section 22 (a) when that section was not raised before the court?

(E) Could the court below add to the findings of fact of the Board of Tax Appeals by assuming that because of the relationship existing between the donor and the beneficiaries, it is wholly improbable that a beneficiary would resort to a Court of Equity to restrain an abuse of discretion by the trustee, (R. 65) or that in view of the family relation a consent to termination of the trust would be freely given?

Reasons Relied Upon for Allowance of the Writs.

1. The decisions of the court below holding that "the power to revest in the grantor title to the whole of the corpus was vested in the donor under each trust instrument, and that the whole of the income is taxable to the donor" under section 166 of the Revenue Act of 1934, because of the provision in each trust that the trustees may pay out such sums from the principal as in their opinion is necessary for the comfort, maintenance or education of any beneficiary, is in direct conflict with the decision of the Circuit Court of Appeals for the First Circuit in *Higgins* v. *White*, 93 F. (2d) 357.

2. The decision of the court below that the powers granted to the trustees were in substance powers reserved by the donor and that such powers were equivalent to ownership of the corpus, disregards the separate entity of the trustee, and is in conflict with the decision of this Court in *Reinecke* v. *Northern Trust Company*, 278 U. S. 339; *Higgins* v. *White*, 93 F. (2d) 357, 358.

3. The decision of the court below that, considering the various powers given to the trustees and the relationship of the grantor and the beneficiaries, the trust accomplished nothing more than an arrangement for distribution of income to a family group at the will of the grantor and that consequently the income was taxable to the donor under the rule of *Helvering* v. *Clifford, Jr.*, 60 S. Ct. 554, 308 U. S. —, is not in accordance with the doctrine enunciated in the *Clifford* case and fails to note the essential distinguishing features between the instant cases and the *Clifford* case. The beneficiaries and grantor in the instant cases cannot be considered a "family group." The trusts in these cases are not short term trusts, but provide for permanent dispositions of both income and corpus to beneficiaries other than the donor.

The court below failed to note that in reality no power of the trustees could be abused for the benefit of the grantor.

4. Writs of Certiorari should be granted in these cases, which involve trusts in usual and ordinary form, and the court should consider and direct the application of its decision in *Helvering* v. *Clifford, Jr.*, 60 S. Ct. 554, 308 U. S. —, to these trusts and to similar trusts in cases now pending in other Circuit Courts of Appeal. The decisions of the Board of Tax Appeals in recent months are inconsistent in the application of this Court's decision in the *Clifford* case and the application of sections 22 (a) and 166 of the applicable revenue acts to trusts similar to those herein involved. Considerable confusion exists with reference to the taxation of the income from trust estates and this court should further clarify the law with reference to this important question.

We are advised that there are several thousand controversies, involving the question whether trust income is taxable to the grantor, now pending in the Bureau of Internal Revenue, before the Board of Tax Appeals or in the Federal Courts, a great many of which involve substantially the questions raised herein.

Conclusion.

Wherefore, it is respectfully submitted that this Petition for Certiorari should be granted.

Robert R. Stone,
National Reserve Building,
Topeka, Kansas.
Ellis D. Bever,
Wheeler Kelly Hagny Building,
Wichita, Kansas.

SUPREME COURT OF THE UNITED STATES

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No. 198

ROBERT R. COX,

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COMMISSIONER OF INTERNAL REVENUE,

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No. 199

ETHEL K. CHILDERS,

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF OF ROBERT R. COX AND ETHEL K. CHILDERS IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

Argument.

We wish to emphasize that the trusts in the instant cases are not term trusts or any other form of temporary reallo-

cation of income within close family groups, but represent permanent dispositions of both income and corpus to the beneficiaries of the trusts, which in the *Childers* case includes two adopted children, a sister-in-law and two sisters. In the *Cox* case the beneficiaries include a brother, cousin, three children and the grantor's wife. In neither of the trusts is the relationship of the beneficiaries and the grantor such that they could be considered a close family group. The trusts contain usual and customary provisions and show on their faces that they were created to make permanent provision for the beneficiaries but to guard against dissipation by the beneficiaries of the assets forming the corpus.

A.

Where the grantor of a trust is one of the trustees and also one of the beneficiaries, a provision in the trust instrument permitting the trustees, in case the net income allotted for the benefit of any beneficiary is insufficient in the opinion of the trustees for his comfort, maintenance and/or education, to pay to such beneficiary such sums from the principal of the trust as may be necessary for such purposes, does not constitute a power to revest in the grantor title to the corpus of the trust, within the meaning of Section 166 of the Revenue Act of 1934.

The court below held in the instant cases that the power granted to the trustees, one of whom was the donor, under paragraph Second (d) of the Childers trust instrument and paragraph Second (c) of the Cox trust instrument (R. 39 and R. 16), to pay to any beneficiary such sums from the principal as might be necessary for the comfort, maintenance or education of any beneficiary, constituted a power to revest in the grantor title to the whole of the corpus, since by virtue of other provisions of the trust instrument

and the relation of the parties, the court considered it improbable that any beneficiary or the co-trustee would act to prevent the abuse of authority by the trustees under this section.

The trustees in the instant cases could make such payments to any beneficiary from the corpus of the trust, only on the contingency that the net income allotted for the benefit of such beneficiary is insufficient, in the opinion of the trustees, for the comfort, maintenance or education of such beneficiary (R. 16 and R. 39).

In the case of *Higgins* v. *White*, 93 F. (2d) 357, the Circuit Court of Appeals for the First Circuit held that a similar provision in the trust instruments involved in that case was not a "power to revest" in the grantor title to the corpus of the trust and that the income was not taxable to the grantor under section 219 (g) of the Revenue Act of 1926 (44 Stat. 32, 34), which corresponds to section 166 of the Revenue Act of 1934 (48 Stat. 680, 729). In that case, under one of the trusts, Clara C. Higgins, the grantor, was also one of the trustees and her husband and children were the beneficiaries. By the terms of the trust agreement the trustees might pay to grantor or to her children such sums out of the principal as the trustees might deem necessary or advisable for the "comfort, maintenance, support, advancement, education or welfare" of grantor or her children. The court decided the question on the broad ground that such a fiduciary discretion was not a "power to revest" in the grantor title to the whole corpus but that such a provision in the trust instrument was a fiduciary power which could be exercised only by the trustees as such after they had made a determination as trustees that it was necessary or advisable to use principal of the trust for the comfort, maintenance or support of Clara C. Higgins or the education of her children. The court held that the trustees

had a fiduciary duty to protect the interests of the beneficiaries against invasion of the corpus unless the contingency stated in the trust instrument were shown to exist. The same conditions are imposed on the trustees in the instant cases (R. 16 and R. 39).

In the instant cases the court below disregarded the rule of *Higgins* v. *White*, 93 F. (2d) 357, and extended the rule of *Rollins* v. *Helvering*, 92 F. (2d) 390, decided by the Circuit Court of Appeals for the Eighth Circuit. In the latter case a trust instrument gave the trustee power to pay to the grantor so much of the principal of the trust "as in its discretion it may deem advisable for our proper education, care, comfort and support." The case involved the taxability to the grantor of certain capital gains derived from a sale in August, 1929, which under the terms of the trust were to be considered as corpus. The trust instrument gave the grantor power to revoke any or all beneficial interests after January 1, 1930, without the consent of anyone, merely by giving notice prior to the end of 1929, which was only a few months after the trust was created. The court held that the grantor was taxable on the income from the capital gains under Section 167 of the Revenue Act of 1928, since the grantor could have distributed to himself these capital gains in 1929, and there was really no adverse interest whatever to object to such a distribution. In the *Rollins* case, neither one beneficiary nor all beneficiaries together could have successfully objected in court to a distribution to the grantor on December 30, 1929, of such capital gains, for the grantor could have given notice of revocation on December 31, 1929, and revoked the trust on January 2, 1930. The facts of the instant cases are quite different, for in these cases there is a real, continuing adverse interest in each beneficiary, which can prevent any direct revocation, or could prevent any concealed revocation by any attempted abuse of trustee powers by the grantor.

B.

Where property is transferred by an individual to himself and another as trustees, the powers granted to trustees to withhold and accumulate the income for future distribution to the beneficiaries; to determine the mode in which expenses are to be borne as between capital and income and to determine the proper division of receipts between capital and income; to freely invest the corpus and accumulated income; to pay to the beneficiaries such sums from the principal of the trust as may be necessary for the comfort, maintenance and education of any beneficiary in the event the net income allotted for the benefit of such beneficiary is insufficient therefor in the opinion of the trustees, do not constitute a power to revest in the grantor title to the entire corpus under Section 166 of the Revenue Act of 1934, when the only power reserved in the trust instrument to alter, amend or revoke the trust must be exercised with the consent of a beneficiary then sui juris and having a substantial adverse interest to the grantor.

The court below has assumed that, because of the relationship of the grantor and beneficiaries, no beneficiary would object to an abuse by the trustees of the powers granted to them under the trust instruments and that the grantor could, therefore, revoke the trust by abusing the powers as trustee. There are no facts in the record to justify such an assumption and the failure of a beneficiary to protect his interests against abuse of the powers granted to the trustees, would not lessen his rights, nor give the grantor any power under the trust instrument.

The Congress has specifically provided in section 166 of the Revenue Act of 1934, that the power to revest in the grantor title to the corpus of the trust, with the consent of a beneficiary having a substantial adverse interest to the grantor, shall not bring the trust within section 166.

Neither the Board of Tax Appeals nor the court below has suggested that any beneficiary in the instant cases did not have a "substantial adverse interest" in the disposition of the entire corpus or the income therefrom.

It cannot be disputed that the Kansas courts would, at the request of any beneficiary or of the co-trustees, prevent any abuse of powers granted to the trustees. *Keeler* v. *Lauer*, 73 Kan. 388, 85 Pac. 541 and *Niblack* v. *Knox*, 101 Kan. 440, 167 Pac. 741. The only way the grantor could use any part of the corpus for her own individual benefit and have such action sustained under local law would be to secure the consent to a revocation or alteration under paragraph Sixth of the instrument (R. 46) which would not bring the trusts within the provisions of section 166 of the Revenue Act of 1934.

C.

The power granted to E. K. Childers as one of the trustees, together with her relationship to the beneficiaries, do not make the trust a mere "sham" so that it should be disregarded for income tax purposes as lacking substance and the income taxed to the grantor under the provisions of Section 22 (a) of the Revenue Act of 1934.

The court below held that "* * * the trust amounted to no more than an arrangement for distribution of income to the family group in accordance with the will of the donor * * * ", and consequently the income was taxable to the grantor under section 22 (a) of the Revenue Act of 1934.

The record herein clearly shows that title to the corpus was transferred to the trustees, that there has been a complete accounting to each beneficiary for his share of the trust income, and that no portion of the corpus of either trust has been withdrawn or distributed for any purpose whatsoever (R. 12 and R. 35).

Control over the corpus was in the trustees as such. No such control was retained by either of the donors as individuals. In *Helvering* v. *Clifford*, 60 S. Ct. 554, 308 U. S. —, relied upon so strongly by the court below, the donor, as such, retained much broader control than was given to the trustees in the instant cases. Clifford had absolute discretion to pay the whole or any part of the net income to the beneficiary, his wife. He retained full power as donor to vote the stock, to hold any of the trust property in his individual name or in the names of other persons. The title to the trust corpus was not transferred to the trustee but the donor merely declared himself trustee of certain securities which he owned.

All this is not true in the instant cases. Here, no control whatever was retained by the donors as such; all powers granted were trust powers to be exercised by the trustees acting in their fiduciary capacity; the trustees might accumulate the income but must set it aside in separate income funds "for future distribution to such beneficiaries;" only the trustees as such could vote the stock or sell or invest any of the trust property; and in each case the title to the trust corpus was actually transferred to the trustees. Clearly there was no such retention of control by the donors in the instant cases as the *Clifford* case.

The *Clifford* decision was predicted on three points taken together: The fact that it was a term trust; the retention of control by the donor as such; and the fact that donor's wife was the beneficiary. These are not the circumstances in the instant case.

The relationship of the parties in the instant cases is not such as can be considered a close family group. In the Childers trust the relationship of the beneficiaries to the grantor and their ages when the trust was created, follows: son, age 10; daughter, age 8; sister-in-law, age 48; sister, age 47; and a sister, age 40 (R. 35). In the Cox trust the

relationship of the beneficiaries to the grantor and their ages when the trust was created, follows: wife, age 36; daughter, age 8; daughter, age 6; son, age 5; brother and cousin (R. 11).

It is unusual for an individual to make a gift of property to a stranger. If the relationship of the beneficiaries to the donor in the instant case constitutes such a close family group within the intendment of the rule laid down in *Helvering* v. *Clifford*, 60 S. Ct. 554, 308 U. S. —, that a consent by the beneficiaries to a revocation of the trust or an abuse of trustee powers will be presumed, then very few trusts created by way of gift have any validity for income tax purposes. We do not so interpret this Court's decision in the *Clifford* case.

D.

The court below did not properly consider Section 22 (a) when that section was not raised in the argument before the court.

The Board of Tax Appeals held that the instant trusts were taxable to the grantors under section 167. In the Circuit Court of Appeals the respondent did not urge section 167 but contended that the trusts came under section 166. In its opinion the court below held that the income is taxable to the grantors under section 166 and also under section 22 (a). The latter section was not raised as an issue before the court below and should not have been considered. *Helvering* v. *Wood*, 60 S. Ct. 551, 308 U. S. —.

If the court's decision below should be upheld solely on the basis of section 22 (a), the cases should be remanded to the Board of Tax Appeals to give petitioners an opportunity to present evidence with respect to that issue. *Helvering* v. *Gowran*, 302 U. S. 238.

E.

The court below could not add to the findings of fact of the Board of Tax Appeals by assuming that because of the

relationship existing between the donor and the beneficiaries, it is wholly improbable that a beneficiary would resort to a court of equity to restrain an abuse of discretion by the trustee (R. 65), or that in view of the family relation a consent to termination of the trust would be freely given.

Under the stipulation of facts (R. 35), which facts were found by the Board as stipulated, the beneficiaries included two sisters and a sister-in-law, the only other beneficiaries being minors not *sui juris*. The assumptions by the court below that, because of the relationship existing between the donor and the beneficiaries, it is wholly improbable that a beneficiary would exercise his right to resort to a court of equity to restrain the discretion of the donor (R. 65) and (b) that "in view of the broad powers of the donor, as trustee, and the family relation, we think it may be reasonably assumed that such a consent (to terminate the trust) would be freely given", (R. 66), are assumptions of facts not found by the Board, and not appearing in the record. The court is without power to find facts or to add to or alter the findings of fact by the Board, *Helvering* v. *Rankin*, 295 U. S. 123, 130.

The Writs Should be Granted.

There are many cases in litigation before the Board of Tax Appeals and the courts at the present time involving trust instruments with similar provisions to those of the instant cases. The decision in all of such cases calls for the application of the rule announced in *Helvering* v. *Clifford*, 60 S. Ct. 554, 308 U. S.—, which rule, the petitioners believe, has been extended beyond its intendment by the decisions of the court below in the instant cases. It is, of course, difficult to find identical provisions in trust instruments or to find other cases involving exactly the same combination of trust provisions. However, the various decisions of the Board of Tax Appeals and the courts do

not give a harmonious interpretation of the rules announced in the case of *Helvering* v. *Clifford,* 60 S. Ct. 554, 308 U. S. —. For example, in the cases of *Dunlevy Milbank,* 41 B. T. A. #137, and *Lolita S. Armour,* 41 B. T. A. #105, the Board of Tax Appeals held that the doctrine of *Helvering* v. *Clifford* was not to be extended to cases in which the beneficiaries were merely relatives of the grantor and were not members of his immediate family circle. The following cases now in litigation all involve the question of whether or not powers reserved by the grantor or granted to trustees under the trust instruments were sufficient to make the trusts revocable trusts under section 166 of the Revenue Acts, or were sufficient to destroy the reality of the trusts and maks the income taxable to the grantor under section 22 (a) of the Revenue Acts. *Alfred C. Berolzheimer,* 40 B. T. A. 644, appealed by Commissioner to C. C. A. (Second Circuit); *Raol H. Fleischmann,* 40 B. T. A. 671; appealed to C. C. A. (Second Circuit); *Carleton H. Palmer,* 40 B. T. A. 1001, appealed by Commissioner to C. C. A. (Second Circuit); *Ellsworth H. Buck,* 41 B. T. A. 99, appealed by Commissioner to C. C. A. (Second Circuit); *Lolita S. Armour,* 41 B. T. A. #105; *Morton Stein,* 41 B. T. A. #134; *Edna B. Elias,* 41 B. T. A. #148; *Henry A. B. Dunning,* 41 B. T. A. #147, which involved the same trust instrument considered by the Board in *Henry A. B. Dunning,* 36 B. T. A. 1222; and *Frederic H. Frazier,* 41 B. T. A. 146, appealed by Commissioner to Circuit Court of Appeals (Second Circuit).

All of which is respectfully submitted for consideration of the Court.

Robert R. Stone,
National Reserve Building,
Topeka, Kansas.

Ellis D. Bever,
Wheeler Kelly Hagny Building,
Wichita, Kansas.

APPENDIX A.

Section 22 (a) of Revenue Act of 1934.

"General definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly."

Section 166 of Revenue Act of 1934.

"Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

"(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

SUPREME COURT OF THE UNITED STATES

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RESPONDENT.

On Petition for Writs of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

REPLY BRIEF OF PETITIONERS.

ELLIS D. BEVER,
Wichita, Kansas,
ROBERT STONE,
Topeka, Kansas,
Attorneys for Petitioner.

Stone, McClure, Webb, Johnson and Oman,
of Counsel.

KELLEY PRINTING CO., TOPEKA

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On Petition for Writs of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

REPLY BRIEF OF PETITIONERS.

The petitioners beg leave to suggest in reply to brief for the respondent that the case of *Fulham v. Commissioner*, 110 Fed. (2) 916, decided by the same Court which decided *Higgins v. White*, 93 Fed. (2d) 357, does not overrule *Higgins v. White*, nor is it applicable to the case at

bar. The Fulham case goes to the question of whether the beneficiary had a substantial adverse interest. That question is not raised, in the cases at bar, and it was not decided by the court below.

In the Fulham case, the wife, Mrs. Fulham, was held not to have a substantial interest. The grantor, the husband of Mrs. Fulham, conveyed certain property to himself and another as co-trustee, the instrument providing:

> "Until the death of my wife, Mary E. Fulham, the trustees shall accumulate the income of the trust fund. During my wife's life the trustees may pay to her at any time or from time to time any part or parts or the whole of the principal and all accumulated income of the trust fund."

Other clauses contained detailed provisions, operative upon the death of Mrs. Fulham, for the payment of the income, and eventually the principal, to the children of the grantor or their issue; set up a Committee of three named persons having no interest in the trust, any two of whom could change, alter or revoke any or all provisions of the trust instrument, and could declare new trusts in any way or manner. By the Committee's own amendment they could not, while Mrs. Fulham was living and competent to act, revest in the grantor title to the corpus or income without the consent of Mrs. Fulham. This was the only restriction on them. Mrs. Fulham's only interest in the trust was the possibility of receiving principal or income under the above quoted clause. No payments under said clause had ever been made to her.

The immediate question, therefore, was whether Mrs. Fulham had a "substantial adverse interest". The Court held that Mrs. Fulham did not have a "substantial adverse interest" because there was no criterion laid down for the guidance of the trustees by which payments of the income or principal could be made to her, and because the Committee, which had no adverse interest, could amend the trust to wipe out her interest. The Court distinguished the case from Higgins v. White and similar cases in the following language:

> "True, it is provided that the trustees 'may' make payments to Mrs. Fulham. *** But no criterion is laid down for the guidance of the trustees, as in Corkey v. Dorsey, 232 Mass. 97, 111 N. E. 795 (1916), relied on by petitioner, where the trustee was empowered to make payment to a designated beneficiary when in the judgment of the trustee, the beneficiary 'is deserving and in need of aid' in such sum as the trustee 'may deem expedient or necessary' for the best interest of the beneficiary. *** It does not appear in the record that Mrs. Fulham has in fact been receiving any payments."
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> * * * * *
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> "The insubstantial character of Mrs. Fulham's interest in the corpus of the trust is further evident from the fact that the committee could at any time by further amendment of the trust instrument destroy her interest, whatever it is, by taking away from the trustees the power to make payments to her. No such feature was present in Corning v. Commissioner, 104 Fed. (2d) 329. Moreover, that case *** is not a contrary authority, for there, the person having the veto power over revesting the corpus in the grantor had a more substantial interest than Mrs. Fulham, here, and according to the court 'in any event

> would receive the corpus if he survived the petitioner the grantor.' *** Our decision in Higgins v. White, 93 Fed. (2d) 357, is not now relevant because in that case the power which the trustees vested in the grantor and his co-trustee to revest the corpus in the grantor if 'the trustees shall deem it wise so to do', was held to be a fiduciary power subject to the control of a court of equity, and not an absolute and unconditional power vested in the grantor either alone or in conjunction with the other trustees."

The Court further referred to *Dumaine v. Dumaine,* 16 N. E. (2) 625 (Mass. 1938). That case involved the construction of a provision in a trust instrument that the trustee:

> "shall have full power and discretion to determine whether any money or other property received by him is principal or income without being answerable to any persons for the manner in which he shall exercise that discretion."

The Court there held that the trustee did not have uncontrolled discretion, and said:

> "This court has uniformly held that trustees in whom a discretion is vested are under an obligation to exercise a 'sound judgment and a reasonable and prudent discretion.' (citations) 'That kind of power and discretion which inheres in a fiduciary relation and not that illimitable potentiality which an unrestrained individual possesses respecting his own property.' (citations) 'Soundness of judgment which follows some due appreciation of trust responsibility.' "

In the instant case, there is a criterion laid down for the guidance of the trustees, in language very similar to

that in Higgins v. White. It is contained in Paragraph Second (d) (T. 39) of the trust agreement (Childers).

In the case at bar, there is no such committee as in the Fulham case, and no power to revoke or revest or to consent to the same is placed in any specific person. It is expressly provided in Paragraph Sixth of each instrument (T. 21, 46) that the trust agreement may be altered, amended or revoked by the donor only in conjunction with any other beneficiary then *sui juris* and *having a substantial adverse interest* in the corpus or the income therefrom. If a son, daughter, sister, brother or any other beneficiary who attempts to join in altering, amending or revoking the instrument do not have a substantial adverse interest, then that beneficiary does not have the power to join in such act and the act would be a nullity. If it be contended by Respondent that a son, being dependent upon a grantor, or a wife, being a member of his immediate family, is by that very reason incapable of having a substantial adverse interest, petitioner respectfully submits that such is not the law nor was it in contemplation of Congress in passing the statutes under construction here. But even if such were the law, then under the terms of the trust instruments such beneficiaries could not join in an alteration, amendment or revocation. To argue that any of the beneficiaries in these trusts does not have a substantial adverse interest, is to argue that the beneficiary's power to join in altering, amending or revoking is nullified. In the Fulham case, power to join in a revocation was vested in

Mary E. Fulham, irrespective of whether she had or had not a substantial adverse interest. There is no such provision in the trusts at bar.

In the Fulham case, the Court said that on the face of the instrument, the main objective seemed to be to accumulate the income during the life of Mrs. Fulham for the benefit of the children. The primary direction to the trustees under the instrument, was to accumulate the income. In the instant case, the instrument shows that the main objective of the trust was to pay the entire corpus and 9/10 of the income to beneficiaries other than donor; and the primary direction to the trustees, under the instrument, was to pay out and distribute to the beneficiaries all of the income, currently. Only in the event that the trustees, in their discretion, considered it for the best interests of the beneficiaries, was the income to be accumulated instead of being distributed all at once, and then was to be conserved only for the purpose of future distribution to the respective beneficiaries. The beneficiaries, other than donor, eventually will receive all of their accumulated income and all of the corpus.

The record (T. 12, 35) shows that substantial distribution of income has been made in the cases at bar each year. In the Cox case there has been virtually no accumulation. In the Fulham case, no distribution whatever was made to Mrs. Fulham.

We, therefore, respectfully submit that the Fulham case should not operate to prevent the granting of the Writs of Certiorari herein.

ELLIS D. BEVER,
Wichita, Kansas,

ROBERT STONE,
Topeka, Kansas,

Attorneys for the Petitioner.

Stone, McClure, Webb, Johnson and Oman,
Topeka, Kansas,
Of Counsel.

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CITATIONS

249346—40

In the Supreme Court of the United States

October Term, 1940

No. 198

Robert R. Cox, petitioner

v.

Guy T. Helvering, Commissioner of Internal Revenue

No. 199

Ethel K. Childers, petitioner

v.

Guy T. Helvering, Commissioner of Internal Revenue

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals in the *Childers* case (R. 46–53) is reported in 39 B. T. A. 904. In the *Cox* case only a short memorandum

opinion was filed (R. 22), in which the Board referred to the opinion in the *Childers* case as being controlling. The single opinion rendered by the Circuit Court of Appeals for the Tenth Circuit in both cases (R. 61–66) is reported in 110 F. (2d) 934.

JURISDICTION

The judgments in both cases were entered by the Circuit Court of Appeals on April 4, 1940 (R. 66–67). The petition for writs of certiorari was filed July 2, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The single question in each case is whether, under the particular trust instrument involved, the donor retained sufficient dominion over the corpus or the income of the trust to warrant taxing him with respect to the income therefrom.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pp. 11–14.

STATEMENT

Each of the petitioners transferred property in trust by agreements dated May 16, 1932. In one, hereinafter referred to as the Cox trust, Robert R. Cox is the donor and Robert R. Cox and E. K. Childers are the trustees. In the other, hereinafter referred to as the Childers trust, E. K.

Childers is the donor and E. K. Childers and Robert R. Cox are the trustees. (R. 13, 36.)

The Cox trust instrument provides that the trustees shall pay one-half of the net income derived from the trust estate to Robert R. Cox during his lifetime, and that designated fractional parts "of all net income not paid to said Robert R. Cox shall be paid" to the other beneficiaries (R. 14). The Childers trust instrument provides that one-tenth of the net income received by the trustees after December 31, 1932, shall be paid to E. K. Childers during her lifetime, and that designated fractional parts "of all net income not paid to said E. K. Childers shall be paid" to the other beneficiaries (R. 38, 45).

The trust instruments contain many provisions common to both. Each provides that during the lifetime of the donor, the trustees may, in their sole discretion, pay to any beneficiary only part of his or her income, and that the balance shall be held and accumulated by the trustees for future distribution to such beneficiary in such amount and at such time as shall be determined solely by the trustees. (R. 16, 39.)

Each provides that (R. 16, 39):

> In case the Net Income from the Trust Estate allotted for the benefit of any beneficiary hereunder is at any time or times insufficient, in the opinion of the Trustees, for the comfort, maintenance and/or education of such beneficiary, the Trustees may

> pay out from time to time such sums from the principal as in their sole discretion may be necessary for such purpose or purposes.

Each provides that during the minority of any beneficiary entitled to receive income, payment of the whole or of any part thereof may in the sole discretion of the trustees be withheld (R. 16, 39).

Each provides that the trustees may determine the mode in which expenses are to be borne as between corpus and income, and which moneys or property of the trust estate shall be treated as corpus and which shall be treated as income, and that such determination shall be conclusive and binding upon all persons (R. 19, 42–43).

Each provides that the trustees shall, from time to time as they deem advisable, invest and reinvest the trust estate in certain specified types of securities. Each further provides that during the lifetime of the donor the trustees may invest and reinvest the trust estate in the unsecured notes of any individual approved by the donor, as trustee, or in the unsecured notes or bonds of any corporation, firm, or syndicate, in which the donor is at the time a stockholder, partner, or member, and that the trustees shall not be liable for any loss resulting to the trust estate from or on account of any such investments approved by the donor, as trustee. (R. 18, 42.)

The Cox trust instrument provides that Robert R. Cox, as trustee, shall make any and all invest-

ments of the trust estate in his sole discretion, shall have the custody of all securities, funds, and other property of the trust estate, and shall make all payments and distributions provided thereunder while he is such trustee (R. 19). The Childers trust instrument makes the same provision with respect to E. K. Childers, as trustee (R. 43).

The Cox trust instrument provides that in all matters wherein any discretion is granted the trustees by the trust instrument, the decision of the truetee Robert R. Cox shall be conclusive and binding upon both trustees, and on all beneficiaries thereunder (R. 19). The Childers trust instrument makes the same provision respecting decisions of E. K. Childers, as trustee (R. 43).

Paragraph six of each trust instrument, as amended June 11, 1932, provides that "This agreement, and the Trust hereby created, may be altered, amended, and/or revoked, in whole or in part, at any time, and from time to time, by the Donor, in conjunction with any other beneficiary" then *sui juris* and having a substantial adverse interest in the disposition of the corpus of the trust or the income therefrom, and that in the event of a complete revocation, the entire corpus and all accumulated income shall be transferred and delivered to the donor (R. 21, 46).

The Cox trust instrument provides that upon the death of the donor, the trust shall terminate and the accumulated income then in the hands of the

trustees shall be distributed to the beneficiaries entitled to receive the same, and the corpus paid over in certain designated proportions to named beneficiaries, or, in the event of the death of a named beneficiary prior to such termination, to his or her lawful issue (R. 16–17).

The Childers trust instrument contains the same provision, except that instead of providing for the distribution of accumulated income, it provides that it shall be added to the corpus and the whole divided into five equal parts and distributed to five named beneficiaries, or, in the event of the death of a named beneficiary prior to such termination, to his or her lawful issue (R. 40).

The beneficiaries named in the Cox trust instrument, in addition to the donor, are his wife, two daughters, a son, a brother and a cousin (R. 14–15). At the termination of the trust, one-half of the estate is to be paid to the wife, and one-sixth to each of the donor's children (R. 17).

The beneficiaries named in the Childers trust instrument, in addition to the donor, are her son, her daughter, two sisters and a sister-in-law (R. 38–39). At the termination of the trust, the corpus is to be paid in equal shares to each of these beneficiaries (R. 40).

The Commissioner determined that the entire net income of each trust for the year 1934 was taxable to the donor thereof and he assessed deficiencies against each petitioner accordingly (R. 13, 22,

36, 50). His action was sustained by the Board (R. 22, 53–54) and the court below affirmed (R. 66–67).

ARGUMENT

The court below held that the income from the trust in each case was taxable to the grantor; it relied for its decision upon both Section 166 and Section 22 (a) of the Revenue Act of 1934. The decision with respect to both sections is, we believe, plainly correct and accords with the applicable decisions of this Court, as well as with the decisions of other circuit courts of appeals.

1. The holding of the court below that the income of the trust was taxable to the grantor under Section 166 was based on the specific provisions of the particular trust instruments involved, which the court interpreted as giving each grantor power to vest in himself title to the whole of the corpus. Somewhat similar trust instruments were similarly construed in *Rollins* v. *Helvering*, 92 F. (2d) 390 (C. C. A. 8th), certiorari denied, 302 U. S. 763, and in *Fulham* v. *Commissioner,* 110 F. (2d) 916 (C. C. A. 1st).

Petitioners urge that this aspect of the decision is in conflict with *Higgins* v. *White,* 93 F. (2d) 357 (C. C. A. 1st). That case, however, involved a funded insurance trust with a trust company as co-trustee; the primary application of the income was to the payment of premiums on life insurance policies. Examination of the provisions of the

trust indenture, as set forth in the opinion of the court, shows plainly that the power retained by the grantor to control disposition of the corpus was in no way comparable with the power retained by the grantors here. The Circuit Court of Appeals for the First Circuit, which decided *Higgins* v. *White,* subsequently held that decision to be inapplicable to a case where the grantor of the trust retained substantial domination over the corpus. *Fulham* v. *Commissioner, supra.* Since the trusts here involved are similar in character to the trust in the *Fulham* case, petitioners' claim of conflict with *Higgins* v. *White* seems plainly unfounded.[1]

2. The holding of the court below that the income was taxable to the petitioners under Section 22 (a) as well as under Section 166 is clearly a correct application of this Court's decision in *Helvering* v. *Clifford,* 309 U. S. 331. There, as here, the Board of Tax Appeals found that the donor of the trust had failed to relinquish dominion over the corpus of the trust and that the trust income was, therefore, taxable to him under Sections 166 and 167. In view of the broad powers retained, the close family relationship, and other pertinent circum-

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[1] *Higgins* v. *White* was decided prior to the action of this Court in denying certiorari in *Rollins* v. *Helvering, supra.* A supplemental brief was filed by the petitioner in the *Rollins* case (Nos. 603–607, October Term, 1937) for the specific purpose of showing conflict between the *Higgins* and *Rollins* cases, but this Court denied certiorari.

stances, this Court concluded that the result reached by the Board should be affirmed under the provisions of Section 22 (a).

Petitioners seek to distinguish the *Clifford* decision upon the ground that the beneficiaries and donors here cannot be considered a "family group" (Pet. 8). Except for the relatively negligible interest of one-fortieth of the income given to one cousin in the Cox trust (R. 15), the sole beneficiaries under both trusts are the spouse, the children and the brothers and sisters of the respective donors. This seems clearly to be a family group. In any event, the close family relationship existing in the *Clifford* case was merely one of the factors which pointed towards the conclusion that sufficient dominion was retained to warrant the tax.

There is no basis for petitioners' contention (Pet. 18) that the court below was precluded from considering Section 22 (a) because the Board of Tax Appeals had based its decision upon the provisions of Section 166. In *Helvering* v. *Gowran*, 302 U. S. 238, this Court specifically held that a Circuit Court of Appeals may *affirm* a decision of the Board of Tax Appeals upon a theory not presented to or considered by the Board. *Helvering* v. *Wood*, 309 U. S. 344, cited by petitioners, deals with the power of an appellate court to reverse on a ground not presented or considered below. That case is inapplicable here.

CONCLUSION

The decision below is correct and there is no conflict. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

SEWALL KEY,
J. LOUIS MONARCH,
JOSEPH M. JONES,
Special Assistants to the Attorney General.

RICHARD H. DEMUTH,
Special Attorney.

JULY 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * [U. S. C., Title 26, Sec. 22.]

* * * * *

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor. [U. S. C., Title 26, Sec. 166.]

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question." [U. S. C., Title 26, Sec. 167.]

Treasury Regulations 86, promulgated under the Revenue Act of 1934, as amended by T. D. 4759, 1937–2 Cum. Bul. 117, 118:

ART. 166–1. *Trusts in the corpus of which the grantor retains an interest.—(a) Scope.*

—Section 166 prescribes that the income, or any part of the income, of certain trusts shall be taxed, not to the trustee nor to the beneficiaries, but to the grantor because of the fact that the grantor has retained a certain interest in the property of the trust. This article deals with the taxation of such income. The term "corpus," as used in this article, means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(*b*) *Test of taxability to the grantor.*—The sufficiency of the grantor's retained interest in the corpus resulting in the taxation of its income to the grantor is determined by a single test, namely, whether the grantor has failed to divest himself, permanently and definitively, of every right which might by any possibility enable him once more to possess and enjoy in title the trust corpus. For the purposes of this article the sufficiency of the grantor's retained interest in the corpus is not affected by the fact that the grantor has provided that the right to cause the title to the corpus to revest in himself is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the corpus or income therefrom adverse to the grantor.

If the grantor has retained any such interest in the corpus he is taxable on the income therefrom regardless of—

(1) how great or how small, how remote or how contingent the interest may be;

(2) whatever the nature of interest retained may be; whether the interest retained is vested, contingent, in reversion, or otherwise; whether conditioned on the precedent giving of notice, or on the elapsing of a

period of years, or on the happening of a specified event; whether taken by appointment, or by designation in the trust instrument, or merely by virtue of the grantor not conveying his whole estate in the corpus, or otherwise;

(3) the time or times at which such interest will revest the title in the grantor in possession and enjoyment, whether within or without the taxable year, whether or not the time be fixed, determinable or certain to come;

(4) whether, if the revesting in the grantor of title to the corpus is in any way dependent upon the act of anyone, that person be the grantor, or any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

*   *   *   *   *

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

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